

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

FINANCIAL MANAGEMENT AT THE DEFENSE
ADVANCED RESEARCH PROJECTS AGENCY

Report No. 96-215

August 28, 1996

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Department of Defense

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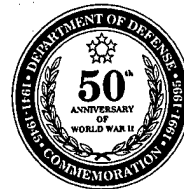
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Acronyms

DAO/WHHS	Defense Accounting Office, Washington Headquarters Services
DARPA	Defense Advanced Research Projects Agency
DFAS	Defense Finance and Accounting Service
NSA	National Security Agency
RDT&E	Research, Development, Test, and Evaluation
WAAS	Washington Headquarters Services Allotment Accounting System



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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August 28, 1996

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE ADVANCED RESEARCH
PROJECTS AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on Financial Management at the Defense Advanced Research
Projects Agency (Report No. 96-215)**

We are providing this report for review and comment. We performed the audit as required by the Chief Financial Officers Act of 1990. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we revised Recommendation B.1. We request that the Defense Advanced Research Projects Agency provide additional comments on the final report to the revised recommendation. We request that the comments be provided by October 28, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Harlan M. Geyer, Audit Program Director, at (703) 604-9594 (DSN 664-9594) or Mr. Charles J. Richardson, Audit Project Manager, at (703) 604-9582 (DSN 664-9582). See Appendix E for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 96-215
(Project No. 6RF-2004)

August 28, 1996

Financial Management at the Defense Advanced Research Projects Agency

Executive Summary

Introduction. The audit was performed in compliance with the Chief Financial Officers Act of 1990 (Public Law 101-576). DoD Directive 7000.14-R, "Financial Management Regulation," volume 1, chapter 2, May 1993, states that general ledger accounts shall be the source of required budget execution reports and annual financial statements submitted to the Department of the Treasury. A June 25, 1995, memorandum from the Deputy Director for Accounting Operations, Defense Finance and Accounting Service Indianapolis Center, instructed Defense agencies that receive Department 97* funds to prepare and submit monthly trial balances to the Defense Finance and Accounting Service Indianapolis Center.

Audit Objectives. The audit objectives were to assess internal controls and compliance with laws and regulations and to test accounting transactions to determine the effectiveness of accounting controls. We limited our review of the management control program to the accounting processes for the Military Equipment, Transportation of Things, and Printing and Reproduction accounts in the Defense Advanced Research Projects Agency uniform chart of accounts. We did not include a review of management controls associated with the adjusted trial balance development process at the Defense Finance and Accounting Service Indianapolis Center. That review will be discussed in the audit report on "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations," Project No. 6RA-2014.

Audit Results. Navy and Air Force organizations responsible for accounting for the suballocations of FY 1995 funds from the Defense Advanced Research Projects Agency did not provide complete and accurate adjusted trial balance information to the Defense Finance and Accounting Service Indianapolis Center. As a result, the FY 1995 Defense Advanced Research Projects Agency adjusted trial balance was understated by at least \$697 million (Finding A). In addition, the Military Equipment account in the adjusted trial balance was understated by at least \$48 million (Finding B). The management control program could be improved by correcting a material weakness related to the accounting control of research equipment assets.

Summary of Recommendations. We recommend that Defense Advanced Research Projects Agency research organizations prepare the adjusted trial balances needed to generate Department 97 financial reports. In addition, we recommend Defense Advanced Research Projects Agency request DoD research organizations to report the value of research equipment purchased with Research, Development, Test, and Evaluation suballotments from the Defense Advanced Research Projects Agency. Also, we recommend reviewing the Defense Advanced Research Projects Agency Military

*Department 97 funds are general fund appropriations allocated to Defense organizations and Military Departments.

Equipment account and making adjusting entries to eliminate any part of the account balance that is either unsupported or does not meet the unit capitalization threshold criteria.

Management Comments. The Navy, the Defense Advanced Research Projects Agency, and the Defense Finance and Accounting Service concurred with the recommendations related to the preparation of adjusted trial balances needed to generate Department 97 financial statements, to make adjusting entries to the Defense Advanced Research Projects Agency equipment account, and to record only the expenses that were incurred during the current fiscal year. The Defense Advanced Research Projects Agency nonconcurred with the recommendation to establish procedures for reporting the value of research equipment that meets capitalization criteria and was purchased with Research, Development, Test, and Evaluation funds. See Part I for a summary of management comments regarding the findings and recommendations and Part III for the complete texts of management comments.

Audit Response. The Defense Advanced Research Projects Agency's comments were partially responsive. We ask that the Defense Advanced Research Projects Agency provide additional comments on the revised recommendation by October 28, 1996.

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Part I - Audit Results

Audit Results

Audit Background

The audit was performed as part the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "The Federal Financial Management Act of 1994," requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 will include the financial statement for the Defense Advanced Research Projects Agency (DARPA).

The Defense Advanced Research Projects Agency. The DARPA is under the direction and control of the Under Secretary of Defense for Acquisition and Technology. The DARPA relies on the Military Departments, Defense agencies, and other organizations to act as agents to conduct necessary research and development projects. Public Law 104-106, under title IX of the FY 1996 Defense Authorization Act, changed the name of the Advanced Research Projects Agency to the DARPA, effective March 8, 1996.

Defense Agency Responsibility for Financial Statements. In a memorandum dated June 6, 1995, the DoD Deputy Chief Financial Officer advised DoD Components of the FY 1996 requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994. The June 6, 1995, memorandum also made the DARPA responsible for the reliability of its financial statements.

Federal Agencies' Centralized Trial Balance System Requirement. On April 1, 1995, the Defense Finance and Accounting Service (DFAS) Indianapolis Center assumed responsibility for preparing financial statements for funding provided from the Office of the Secretary of Defense appropriation, designated Department 97¹, starting with FY 1996. This responsibility included satisfying the Department of the Treasury Federal Agencies' Centralized Trial-Balance System requirements for FY 1995. To meet the requirements of the Federal Agencies' Centralized Trial-Balance System, the Deputy Director for Accounting Operations, DFAS Indianapolis Center, requested in a June 25, 1995, memorandum that Defense agency accounting organizations submit an adjusted trial balance using the general ledger accounts for the period ending September 30, 1995. In addition, the Deputy Director requested that all DoD Components prepare and submit monthly trial balances to the DFAS Indianapolis Center.

Chief Financial Officers Reporting Requirement. During FY 1996, Defense agencies and other submitters of Department 97 financial reports will transition to full trial balance reporting using the DoD Standard General Ledger uniform

¹Department 97 funds are general fund appropriations allocated to Defense organizations and Military Departments.

chart of accounts. The uniform chart of accounts consists of Budgetary Accounts and Proprietary Accounts. Proprietary Accounts include: Assets, Liabilities, Equity, Revenue, Expense, and Gains/Losses/Extraordinary Items.

Audit Objectives

The audit objectives were to assess internal controls and compliance with laws and regulations and to test accounting transactions to determine the effectiveness of accounting controls. We limited our review of the management control program to DARPA and the Defense Accounting Service, Washington Headquarters Services (DAO/WHHS) and did not perform a review of management controls associated with the adjusted trial balance development process at DFAS Indianapolis Center. That review will be included in the audit report on "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations," Project No. 6RA-2014. See Appendix A for a discussion of the audit process and our limited review of the management control program. See Appendix B for prior audit coverage.

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

Accounting organizations responsible for accounting for the suballocations of FY 1995 Research, Development, Test, and Evaluation (RDT&E) funds from the DARPA to the Navy, the Air Force, and the National Security Agency (NSA) did not provide complete adjusted trial balance information to the DFAS Indianapolis Center. The Navy and the Air Force did not provide complete DARPA adjusted trial balances because Navy and Air Force accounting organizations were not using complete general ledger accounting control systems to report DARPA-related proprietary information. In addition, Navy, Air Force, and NSA accounting organizations did not respond to the DFAS Indianapolis Center requests for FY 1995 adjusted trial balance information. As a result, the DARPA portion of the FY 1995 adjusted trial balance submission reflected only \$1.5 billion of the \$2.2 billion DARPA FY 1995 appropriation and was understated by at least \$697 million. Furthermore, ending balances on the DARPA FY 1995 adjusted trial balance do not provide accurate beginning balances for FY 1996 DARPA financial statements.

DARPA Appropriated Funds

In FYs 1994 and 1995, DARPA was appropriated \$2.5 billion and \$2.2 billion, respectively for RDT&E as shown in Table 1. In FY 1995, DARPA suballocated about \$1.2 billion of its budget to the Army, Navy, Air Force, and various Defense agencies. The DAO/WHs performs the accounting function for 51 percent of the funds executed by DARPA Headquarters under the accounting allotment classification code, appropriation limit 1320, using the Washington Headquarters Services Allotment Accounting System (WAAS) as the official accounting system. The Military Departments, supported by DFAS centers in Indianapolis (Army), Cleveland (Navy), and Denver (Air Force), and the NSA accounting organization performed the accounting function for the remaining 49 percent of the RDT&E funds to account for the FY 1995 suballocations received from DARPA.

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

Table 1. DARPA RDT&E Fund Recipients

<u>Accounting Organizations Responsible for Suballocations of RDT&E funds</u>	<u>FY 1994</u> (\$ in thousands)	<u>FY 1995</u> (\$ in thousands)
Limit 1300-(DARPA appropriated funds)		
1301-Army	\$ 340,069	\$ 385,775
1302-Air Force	448,344	382,917
1304-Navy	438,921	402,292
1320-DARPA Headquarters	1,297,010	1,003,080
1342-Defense Nuclear Agency*	1,103	0
1345-NSA	<u>4,347</u>	<u>3,175</u>
Total	\$2,529,794	\$2,177,239

*We do not make further reference to the Defense Nuclear Agency, now the Defense Special Weapons Agency, because it did not receive a DARPA order in FYs 1995 and 1996 and because it had less than \$90,000 of DARPA suballocations to disburse as of June 17, 1996.

Fund recipients have a legal time limit of 2 years to obligate RDT&E funds and an additional 5 years to expend the funds. DARPA suballocates RDT&E funds to DoD research organizations within the Military Departments and to NSA through the use of a DARPA order, which is the official funding document used by DARPA to commit funds to an agent for obligation. A "basic" DARPA order provides the essential terms and conditions of an initial effort. DARPA also issues amendments to transmit subsequent funding and to direct program changes.

Adjusted Trial Balance Submissions

For the DFAS Indianapolis Center to prepare a DARPA adjusted trial balance showing DARPA suballocations for FY 1995, DARPA Headquarters, the Army, Navy, Air Force, and NSA needed to submit adjusted trial balances prepared from general ledger accounts. Accounting organizations supporting the DARPA Headquarters (limit 1320), the Army (limit 1301), and about 22 percent of the funds for the Navy (limit 1304) submitted adjusted trial balance information to the DFAS Indianapolis Center. However, the accounting organizations supporting the Office of Naval Research and other Navy organizations, the Air Force, and the NSA did not submit adjusted trial balances, causing the FY 1995 DARPA trial balance to be understated by at least \$697 million. The adjusted trial balance submissions are discussed below.

Use of General Ledger Systems. DFAS has made progress in developing and using general ledger accounting control systems to support the preparation of the

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

DARPA annual adjusted trial balance. The DFAS Indianapolis Center consolidated the Army accounting information using the Federal Financial System. In addition, the DAO/WHs used the WAAS to account for the DARPA funds managed by DARPA Headquarters. Those two systems accounted for suballocations to Army research organizations (limit 1301), and research managed by DARPA Headquarters (limit 1320), which accounted for \$1.4 billion of the \$2.2 billion allotted to DARPA for FY 1995. In addition, NSA developed a general ledger accounting control system, which with programming adjustments could provide proprietary account information for the funds provided under limit 1345. However, the DFAS Cleveland Center supporting the Navy and the DFAS Denver Center supporting the Air Force did not have the general ledger accounting control systems needed to produce complete adjusted trial balances for suballocations to Navy research organizations under limit 1304 and to Air Force research organizations under limit 1302.

DARPA Headquarters Portion of DARPA Adjusted Trial Balance. The DAO/WHs provided a detailed FY 1995 adjusted trial balance to account for the \$1 billion executed by DARPA Headquarters. The adjusted trial balance generated by the WAAS gave a detailed range of account balances for 27 asset, liability, equity, revenue, and expense accounts. See Appendix C for the WAAS adjusted trial balance submission to the DFAS Indianapolis Center.

Army Portion of the DARPA Adjusted Trial Balance. The DFAS Indianapolis Center prepared detailed adjusted trial balance information for the Army research organizations receiving the DARPA funding. Army research organizations managed about \$386 million of RDT&E funds suballocated by the DARPA in FY 1995. The research organizations enter the adjusted trial balance information on DARPA funding into an Army data base that the DFAS Indianapolis Center could use to prepare the Army portion of the DARPA adjusted trial balance. The Army portion of the DARPA adjusted trial balance contained account balances for 28 asset, liability, equity, revenue, and expense accounts. The Army portion of the DARPA adjusted trial balance submission is included in Appendix C.

Navy Portion of the DARPA Adjusted Trial Balance. Navy research organizations managed about \$402 million of RDT&E funds suballocated by the DARPA in FY 1995. The DFAS Cleveland Center, the Office of Naval Research, and other Navy organizations did not have a complete general ledger accounting control system to account for RDT&E funds that the DARPA suballocated to Navy organizations. As a result, the DFAS Cleveland Center was unable to produce an adjusted trial balance using proprietary accounts for DARPA funds suballocated to the Navy. However, the Navy prepared an adjusted trial balance using budgetary data that accounted for RDT&E funds that the DARPA suballocated to four of the six Navy research organizations. The DFAS Indianapolis Center did not receive an FY 1995 adjusted trial balance to account for an estimated \$311 million of the DARPA funds suballocated to the Office of Naval Research and other Navy organizations.

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

DFAS Cleveland Center Adjusted Trial Balance Submission. The DFAS Cleveland Center did not provide complete adjusted trial balance information for the Navy research organizations receiving DARPA funds. Also, the DFAS Cleveland Center was not using a complete general ledger accounting control system to report for the DARPA funds received by Navy research organizations. Consequently, key proprietary account information was not included in the Navy portion of the DARPA FY 1995 adjusted trial balance. The DFAS Cleveland Center prepared an adjusted trial balance showing six accounts based on budgetary information from the Naval Air Systems Command, the Naval Sea Systems Command, and the Space and Naval Warfare Systems Command. Therefore, the DARPA FY 1995 adjusted trial balance was incomplete and inaccurate. See Appendix C for the DFAS Cleveland Center adjusted trial balance submitted to the DFAS Indianapolis Center.

Personnel at the DFAS Cleveland Center stated that they were unaware of the requirement to report general ledger information on the DARPA funds received by Navy research organizations. Furthermore, the DFAS Cleveland Center maintained that it would not account for the DARPA funds in a general ledger format until the Navy gave the necessary guidance to perform the required accounting functions.

The DARPA provides funds directly to the research organizations to increase efficiency by eliminating successive levels of command. However, the Navy Comptroller's Office stated that the suballocations that go directly to the installation level created a funds control problem because the Navy had not established central control. DARPA personnel stated that the individual Navy research organizations were responsible for the proper accounting and reporting of DARPA suballocations provided to them.

Office of Naval Research Adjusted Trial Balance. The Office of Naval Research received about \$153 million from the DARPA in FY 1995. The Office of Naval Research did not prepare an adjusted trial balance because that office relies on the DFAS Cleveland Center for preparing the necessary financial reports for the DARPA funds. DFAS Cleveland Center personnel were unaware that the Office of Naval Research needed assistance preparing financial data for funds received from the DARPA. Therefore, the Navy portion of the DARPA FY 1995 adjusted trial balance was understated by at least \$153 million. As a result of our audit, the Office of Naval Research prepared a memorandum, dated February 13, 1996, requesting that the DFAS Cleveland Center prepare and submit future annual adjusted trial balances for the Office of Naval Research portion of the DARPA appropriation as well as all future monthly adjusted trial balance reports requested by the DFAS Indianapolis Center.

Other Navy Organizations Adjusted Trial Balance. In FY 1995, other Navy organizations did not submit adjusted trial balances to the DFAS Indianapolis Center to report on the \$158 million suballocated from the DARPA. The organizations did not have a complete general ledger accounting control system to prepare a detailed proprietary adjusted trial balance for the

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

DARPA funding. The lack of reporting by the other Navy organizations caused an understatement of at least \$158 million in the DARPA portion of the FY 1995 adjusted trial balance.

Naval Air Warfare Center Adjusted Trial Balance Submission. The Training Systems Division, Naval Air Warfare Center (the Warfare Center), submitted a four-account adjusted trial balance that accounted for the \$582,000 received from the DARPA. The Warfare Center converted budgetary information to the four accounts because the Warfare Center could not produce proprietary information. Consequently, information for numerous proprietary accounts was not available. See Appendix C for the Naval Air Warfare Center adjusted trial balance accounts submitted to the DFAS Indianapolis Center.

Air Force Portion of the DARPA Adjusted Trial Balance. The Air Force research organizations receive accounting and financial statement preparation support from the DFAS Denver Center. The Air Force does not have a complete general ledger accounting control system to account for DARPA funds suballocated to the research organizations. As a result, the DFAS Denver Center was unable to produce a complete and accurate DARPA portion of the FY 1995 adjusted trial balance due to the lack of proprietary accounts.

DFAS Denver Center Adjusted Trial Balance. In February 1996, the DFAS Denver Center submitted its FY 1995 adjusted trial balance to the DFAS Indianapolis Center. The adjusted trial balance was manually constructed using budgetary data submitted from the various Air Force installations. However, the adjusted trial balance did not contain any general ledger information for the \$383 million that the Air Force received from the DARPA in FY 1995. Therefore, the Air Force portion of the DARPA FY 1995 adjusted trial balance is understated by at least \$383 million.

NSA Portion of the DARPA Adjusted Trial Balance. The DFAS Indianapolis Center did not receive adjusted trial balances from the NSA for the DARPA suballocated RDT&E funds. As a result, the DARPA portion of the adjusted trial balance for FY 1995 was understated at least \$3.2 million for the FY 1995 suballocations and the account balances for any prior year suballocations.

We advised the Director, NSA, of the need to provide adjusted trial balances to the DFAS Indianapolis Center for the NSA portion of the DARPA adjusted trial balance. We did not make a recommendation to the Director, NSA, because financial statement reporting at the NSA is part of the scope of the Inspector General, DoD, Audit of Financial Management at the National Security Agency, Report No. 96-213, August 20, 1996. Additionally, the funds received for the NSA during FY 1995 were less than two-tenths of 1 percent of the reported \$2.88 billion DARPA Fund Balance with Treasury.

Plans for Developing Navy and Air Force General Ledger Accounting Systems

DFAS Cleveland Center Development Efforts. The DFAS Cleveland Center is developing a complete general ledger accounting control system, the Standard Accounting and Reporting System Fund Distribution and Departmental Reporting System (hereafter referred to as the Navy Standard System), for Navy use to account for Department 97 General Funds. The DFAS Cleveland Center is developing the Navy Standard System to satisfy financial and general ledger reporting requirements for Chief Financial Officers Act Financial Statements. The Navy Standard System uses electronic data obtained from other Navy automated data processing systems. As of March 1996, the Navy was not recording all DARPA suballocations on existing accounting systems. The Navy Standard System has the capability to capture all suballocations received directly by Navy research organizations. DFAS Cleveland Center system development managers estimated full implementation of the Navy Standard System by October 1996.

DFAS Denver Center Development Efforts. The Air Force initiated an evaluation of general ledger accounting control systems to account for Department 97 General Funds and selected the Corps of Engineers Financial Management System. The Corps of Engineers Financial Management System will have the capability to capture all suballocations received directly by Air Force research organizations rather than the Air Force Comptroller's Office. DFAS Denver Center personnel estimated full implementation of the selected system by December 1999.

The Effect of Not Using a DoD Standard General Ledger System

The Navy and the Air Force did not use a complete general ledger accounting control system to prepare their portions of the DARPA adjusted trial balance, resulting in incomplete general ledger account information and a \$697 million understatement in the FY 1995 DARPA adjusted trial balance. Table 2 shows the DoD organizations that did not submit adjusted trial balances to account for the DARPA funds received in 1995 and prior years.

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

Table 2. DARPA Fund Recipients That Did Not Submit Adjusted Trial Balances

<u>Organizations</u>	<u>Amount</u> (\$ in millions)
Navy	
Office of Naval Research	\$153.0
Other Navy Organizations	158.0
Air Force	383.0
NSA	<u>3.2</u>
Total	\$697.2

The understated amount may be higher than \$697 million, because the amounts of prior year DARPA suballocations to Navy and Air Force research organizations should have been included in the FY 1995 DARPA adjusted trial balance.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Director, Defense Advanced Research Projects Agency, obtain assurances from fund recipient research organizations that they will provide adjusted trial balance information for FY 1996 to the Defense Finance and Accounting Service Indianapolis Center for generating the Defense Advanced Research Projects Agency portion of the Department 97 financial statement.

DARPA Comments. The DARPA concurred, stating that it would formally notify allotment holders of financial statement reporting requirements no later than August 15, 1996. In addition, the DARPA will include this topic in discussions at its annual conferences in an attempt to assure compliance.

Navy Comments. Although not required to comment, the Navy concurred in principle with the recommendation, but stated that the recommendation should be revised to state that the accounting organizations, rather than fund recipient research organizations, provide assurances to the DARPA, because the accounting organizations servicing the fund recipient research organizations are responsible for preparing adjusted trial balance information.

Audit Response. The DARPA comments were responsive. Regarding the Navy comments, we do not believe the recommendation should be revised. The DARPA funding is sent directly to the research organizations; therefore,

Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

the research organizations are responsible for ensuring that supporting accounting offices are committed to the preparation of the required adjusted trial balance information as needed by the DFAS Indianapolis Center.

A.2. We recommend that the Chief of Naval Research, prepare the adjusted trial balance information, as requested by the Defense Finance and Accounting Service Indianapolis Center, that reflects the Defense Advanced Research Projects Agency suballocations received and expended for use in preparing the Department 97 financial statement.

Navy Comments. The Navy concurred in principle, stating that the DFAS Cleveland Center has agreed to prepare and provide DARPA adjusted trial balance information to the DFAS Indianapolis Center for the Office of Naval Research, beginning September 1996. Further, a meeting is scheduled for DFAS Cleveland Center and Office of Naval Research personnel to coordinate that effort. The Navy believes, due to that agreement, that the recommendation should be revised to state that the DFAS Cleveland Center should prepare the adjusted trial balance information.

Audit Response. The Navy's action achieves the desired results of the recommendation. There is no need to revise the recommendation because the DFAS Cleveland Center knows and understands the requirement to support the DFAS Indianapolis Center preparation of the Chief Financial Officers financial information.

Finding B. General Ledger Accounts

The DARPA adjusted trial balance amounts were not accurate for the Military Equipment asset account and for two expense accounts, Printing and Reproduction and Transportation of Things. Those account balances were not accurate because the DARPA did not have a specific procedural policy for research organizations to report the value of research equipment to the DFAS for inclusion in the DARPA financial statements. Further, the DAO/WHIS did not have documentation to support the military equipment account, and the DAO/WHIS improperly recorded obligations as expenses before the expense was incurred. As a result, military research equipment procured for \$48 million was not recorded on the FY 1995 adjusted trial balance, \$1.6 million of undocumented transactions was recorded in the military equipment account, and two expense accounts reflected negative balances.

Military Equipment Asset Account

DoD Directive 7000.14-R, volume 4, "Financial Management Regulation," January 1995, specifies that the DoD accounting entity that controls the benefit from the use of military equipment shall account for the equipment. The Regulation stipulates that the capitalized value of DoD military equipment furnished to contractors, testing agencies, Defense Industrial Facilities, and others for the primary use of the DoD should be recorded. The Regulation characterizes the equipment as the type that is usually either returned or retained after use or testing rather than incorporated into an end product, consumed, or expended. In FY 1995, the DARPA suballocated \$1.2 billion to 35 DoD research organizations within the Army, the Navy, the Air Force, and the NSA. The research organizations did not report the research equipment they purchased to support DARPA projects as required by the Chief Financial Officers Act of 1990. In addition, there was no supporting documentation for \$1.6 million of the \$1.7 million of military equipment that was reported on the FY 1995 DARPA adjusted trial balance.

Unreported Military Research Equipment. We reviewed the FYs 1994 and 1995 contracts for the research conducted at four research organizations at the Office of Naval Research, Arlington, Virginia; Wright-Patterson Air Force Base, Ohio; and the Air Force Office of Scientific Research, Bolling Air Force Base, Washington, D.C. At those three locations, two contracts and an agreement showed that the Government retained title to equipment purchased for more than \$48 million during FYs 1994 and 1995. The equipment included graphic terminals, special test equipment, and equipment to produce an active matrix liquid crystal display. The research organizations did not report the value of the research equipment to the DFAS for inclusion in the DARPA adjusted trial balance Military Equipment account. The research organizations did not have specific implementing policy to use their own financial reporting systems to report DARPA research equipment.

Finding B. General Ledger Accounts

In a memorandum, dated November 30, 1995, the Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), directed each Defense agency to be responsible for the financial reporting of proprietary information from the DoD organizations receiving Defense agency suballocations. Thus, the accounting organizations supporting DARPA research organizations should include the \$48 million for research (military) equipment in their portions of the DARPA trial balance for FY 1996. Because we reviewed contracts and agreements from only 4 of the 35 DoD research organizations to which DARPA provided funding in FY 1995, the unreported equipment purchases are potentially larger than the \$48 million identified during the audit.

Unsupported Military Equipment. The DAO/WHS reported \$1.7 million as the balance of the Military Equipment general ledger account on the DARPA Headquarters adjusted trial balance. There was no documentation at the DAO/WHS for \$1.6 million of the \$1.7 million of military equipment. Most of the documentation for the remaining \$.1 million was not related to mission equipment, but was instead related to chairs, fabric, and monthly charges for document copying services. Consequently, the lack of documentation makes it impossible to determine whether any of the \$1.7 million of military equipment met the per unit capitalization criteria. The documentation that was available showed that only \$24,000 of military equipment met the capitalization threshold. In our opinion, the entire \$1.7 million balance should be eliminated from the FY 1996 DARPA adjusted trial balance.

Expense Accounts

Negative Balances. The DARPA FY 1995 trial balance did not accurately present the actual activity of the Printing and Reproduction (hereafter referred to as Printing) and Transportation of Things (hereafter referred to as Transportation) expense accounts. The Printing account reflected a negative balance of \$218,303, while the actual FY 1995 expense was \$14,867. The negative balance in the Printing account resulted because the DAO/WHS personnel credited the Printing account for amounts that were obligated in FYs 1991 and 1992 but were never disbursed. Similarly, the Transportation account reflected a negative balance of \$16,284, while the actual current year expense was \$6,243. The negative balance in the Transportation account resulted because the DAO/WHS credited the account for obligated amounts in FYs 1989 and 1990. As part of the FY 1995 year end closing, the WAAS identified prepaid amounts that remained in the two expense accounts, and the DAO/WHS credited the unused prepaid amounts to the expense accounts. The DAO/WHS recorded a portion of the prior year Printing and Transportation expense accounts that were not expended in prior years as a credit in FY 1995. Before FY 1995, the DAO/WHS had not closed out the two accounts for at least 6 years.

Prerecording Expenses. The WAAS manager stated that the WAAS was programmed to accept DAO/WHS accounting entries to record obligated

Finding B. General Ledger Accounts

amounts as an expense when funds were obligated for the Printing and Transportation expense accounts. The WAAS was programmed to record the Printing and Transportation expenses when obligations were incurred to better match the expenses to the year of liability. Before this methodology was adopted, current expenses were severely understated, because several months normally elapsed between the time expenses for printing and transportation were incurred and when the charges were received and posted as expenses. In our opinion, the DAO/WHs used general ledger expense accounts incorrectly. Instead of showing actual year end activity, the DAO/WHs used the Printing and Transportation accounts like budgetary undelivered orders accounts, which represent amounts obligated for goods and services ordered without an advance payment prior to delivery.

Effect on Asset, Equity, and Expense Accounts. The DAO/WHs practice of prerecording expenses when funds were initially obligated resulted in an understatement of the Fund Balance with Treasury Account and the Equity section of the adjusted trial balance. When adjusting entries are made in future years, then expenses will be understated in the year of the adjusting entry and negative account balances may result. In our opinion, prerecording expenses constitutes an improper use of the expense account. The expense account should reflect only the actual expenses incurred during the current fiscal year.

Recommendations, Management Comments, and Audit Response

Revised Recommendation. As a result of management comments, we revised draft Recommendation B.1. We request that the Director, Defense Advanced Research Projects Agency, provide comments on the revised recommendation.

B.1. We recommend that the Director, Defense Advanced Research Projects Agency, request research organizations to report the value of research equipment that meets capitalization criteria and was purchased with Research, Development, Test, and Evaluation funds suballocated by the Defense Advanced Research Projects Agency:

- o to the Defense Finance and Accounting Service for inclusion in the Defense Advanced Research Projects Agency adjusted trial balances and

- o to the Defense Advanced Research Projects Agency Chief Financial Officer for reconciling actual on-hand balances with the amounts included in future year financial records.

DARPA Comments. The DARPA nonconcurred with establishing procedures for reporting the value of research equipment that meets capitalization criteria and that was purchased with RDT&E allotted funds. The DARPA stated that it does not have the authority to direct the Military Departments to implement general ledger reporting systems to capture DARPA proprietary information.

Finding B. General Ledger Accounts

Military Department decisions to exclude DARPA allotments from standard reporting requirements are not influenced by allotments the DARPA sends to an installation.

Audit Response. As a result of management comments, we revised the recommendation. Therefore, we request that the DARPA provide additional comments on the revised recommendation.

B.2. We recommend that the Defense Accounting Officer, Washington Headquarters Services, Defense Finance and Accounting Service Indianapolis Center:

a. Review the Defense Advanced Research Projects Agency Military Equipment account, and make adjusting entries to eliminate any part of the account balance that does not meet the unit capitalization threshold criteria.

DFAS Comments. The DFAS concurred with making adjusting entries to the DARPA equipment account to eliminate any part of the account balance that does not meet the unit capitalization threshold criteria.

b. Record only the expenses that are incurred during the current fiscal year for all general ledger expense accounts.

DFAS Comments. The DFAS concurred with the recommendation and stated that the DFAS Indianapolis Center will no longer record the accrual of transportation and printing expenses while simultaneously recording the obligations.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. We reviewed adjusted trial balance information, submitted by DARPA reporting organizations to the DFAS Indianapolis Center, that supported appropriations of \$2.2 billion in FY 1995, \$2.5 billion in FY 1994 and assets totaling \$3.0 billion as of September 30, 1995. We also reviewed the processes used for developing the DARPA FY 1995 adjusted trial balance. We identified the accounting organizations that support the research organizations that received DARPA suballocations and that were responsible for submitting adjusted trial balances. We reviewed the methods accounting organizations used to prepare their portions of the DARPA adjusted trial balance. We also reviewed the general ledger capability of each accounting organization that supported the research organizations that received a DARPA suballocation. We also assessed the accuracy of the FY 1995 adjusted trial balance and Military Equipment asset accounts and researched the rationale for the two negative expense account balances.

Use of Computer-Processed Data. We relied on computer-processed data without confirming reliability of the data. We did not establish reliability because the overall process for generating DARPA adjusted trial balances was incomplete. Therefore, not establishing the reliability of the data did not materially affect the audit results.

Audit Period, Standards, and Locations. This financial audit was performed from October 1, 1995, through April 30, 1996, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. The audit was performed at the DARPA and at various DFAS Centers. Appendix D lists the organizations visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. The scope of our review was limited to the DARPA and the DAO/WHs management control programs and did not attempt to include the need for management controls at the DFAS Indianapolis Center. We also reviewed the adequacy of management's self-evaluation of applicable management controls.

Adequacy of Management Controls. We identified a management control weakness, as defined by DoD Directive 5010.38, for DARPA. The DARPA management controls for financial asset accountability were not sufficient to

assure correct financial statement reporting for research equipment used on DARPA funded projects. Recommendation B.1., if implemented, will correct the deficiency. A copy of the report will be provided to the senior official responsible for management controls at the DARPA.

Adequacy of Management's Self-Evaluation. The DARPA had not addressed the requirement of accounting for research equipment with the organizations to which it suballocates funds or the need to report those assets on the monthly and end-of-year DARPA trial balance submissions to the DFAS Indianapolis Center. Therefore, the DARPA did not identify or report the material weakness identified by the audit.

Appendix B. Summary of Prior Audits and Other Reviews

The Office of the Inspector General, DoD, issued eight reports in 1995 and 1996 that relate to accounting controls applicable to the preparation of financial statements as part of the Chief Financial Officers Act of 1990.

Inspector General, DoD, Report No. 96-212, "Capitalization of DoD Fixed Assets," August 19, 1996, states that in accounting for assets, the DoD components capitalized and retained in the financial records low-cost items that were below the current capitalization threshold. The report recommends that one capitalization threshold apply to DoD asset accounts (excluding Defense Business Operations Fund accounts) and that all items valued under that threshold be purged for the purposes of financial statement reporting. The Deputy Chief Financial Officer deferred action on the recommendation pending the results of deliberations regarding asset valuation and presentation by the Government-wide Task Force for Audited Financial Statements. Management comments were responsive. Asset valuation and presentation is a priority issue of the Government-wide Task Force for Audited Financial Statements. The Inspector General, DoD, as a member of the Government-wide Task Force for Audited Financial Statements, will work to expedite guidance regarding property, plant, and equipment valuation.

Inspector General, DoD, Report No. 96-161, "Compilation of FY 1995 and FY 1996 DoD Financial Statements at the Defense Finance and Accounting Service, Indianapolis Center," April 24, 1996, states that the DFAS Indianapolis Center consistently and accurately compiled financial data from field entities and other sources into the FY 1995 Consolidated Financial Statements for the Army General Fund. The efficiency of and the internal controls for the compilation processes significantly improved since FY 1993 (the last time the compilation process was reported on). However, improvements in the compilation process were still needed. The DFAS Indianapolis Center could have better explained that variances of up to \$6 billion in financial statement line items from year to year occurred because FY 1995 financial data were not in fact comparable to FY 1994 financial data. Further, the DFAS Indianapolis Center did not prepare a required footnote for the financial statement. Also, controls over making 15 auditor-recommended adjustments for about \$19.5 billion and preparing 165 accounting adjustment vouchers needed improvement. The audit also reviewed the progress of the DFAS Indianapolis Center in assuming the new task of maintaining accounting records and in preparing financial reports for all Defense agencies. Preparations are not yet complete for the compilation of FY 1996 Chief Financial Officers Act financial statements for Defense agencies other than the Army. Basic planning and analysis have been completed, and Defense agency data have been integrated into some parts of the process used to compile the financial statements. The report recommends that the Director, DFAS, improve internal controls over the processes used to compile the Chief Financial Officers Act

Appendix B. Summary of Prior Audits and Other Reviews

financial statements. The Director, DFAS, concurred with all the report recommendations and agreed to explain financial statement line item variances from year to year and to prepare required footnotes.

Inspector General, DoD, Report No. 96-080, "Annual Reviews of User Accounting Controls for the Washington Headquarters Services Allotment Accounting System," February 29, 1996, discusses annual accounting system reviews to determine whether DoD accounting systems are in compliance with accounting principles, standards, and related accounting requirements established by the General Accounting Office, the Office of Management and Budget, the Department of the Treasury, and DoD. The report concludes that annual reviews were not fully coordinated with WAAS users for FYs 1994 and 1995. As a result, annual reviews of the WAAS were incomplete and cannot be relied on to verify the adequacy of principal user accounting system controls. DFAS management did not concur with the recommendations to fully coordinate annual reviews. Instead, in 1995 DFAS developed an automated system-specific annual review process, which was agreed to by the Inspector General, DoD.

Inspector General, DoD, Report No. 96-083, "Accounting Support for Preparation of Joint Chiefs of Staff Financial Statements," January 30, 1996, states that the FY 1994 Joint Chiefs of Staff financial statements prepared by the DAO/WHs were inaccurate. The DAO/WHs reported RDT&E funds to the DFAS on two separate financial statements, resulting in an overstatement of Joint Chiefs of Staff asset, liability, and equity accounts by a total of about \$48 million. In addition, to determine equity for the FY 1994 Joint Chiefs of Staff financial statements, the DAO/WHs calculated equity amounts using information from budget execution reports instead of using proprietary general ledger account information. The budget execution reports did not contain the information needed to prepare complete and accurate FY 1994 financial statements. No recommendations were made because recommendations in prior audit reports should correct the deficiencies.

Inspector General, DoD, Report No. 96-068, "Accounting Support for Preparation of Ballistic Missile Defense Organization Financial Statements," December 29, 1995, states that the FY 1994 Ballistic Missile Defense Organization financial statements prepared by the DAO/WHs were inaccurate and incomplete. The DAO/WHs reported the Ballistic Missile Defense Organization RDT&E funds to the DFAS Indianapolis Center on two separate financial statements, resulting in overstatements of the Ballistic Missile Defense Organization asset, liability, and equity account. In addition, the DAO/WHs used budgetary information from budget execution reports instead of using proprietary general ledger account information to prepare the Ballistic Missile Defense Organization FY 1994 financial statements. Errors and omissions totaling about \$1.9 billion were identified in 12 financial statement accounts. No recommendations were made because recommendations in prior audit reports should correct the deficiencies.

Inspector General, DoD, Report No. 96-048, "Defense Accounting Office, Washington Headquarters Services Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency," December 19, 1995,

Appendix B. Summary of Prior Audits and Other Reviews

states that the DAO/WHS had not implemented DoD financial management directives and related guidance for preparing the Advanced Research Projects Agency financial statements. The DAO/WHS improperly prepared consolidated financial statements for the Advanced Research Projects Agency (now the Defense Advanced Research Projects Agency) using budget execution reports instead of proprietary trial balances. Consequently, the financial statements overstated the Advanced Research Projects Agency financial position by \$2.2 billion in equity. The report recommends that the DAO/WHS establish procedures to verify that the Advanced Research Projects Agency FY 1996 financial statements and subsequent years are accurately prepared in accordance with DoD Directive 7000.14-R, "DoD Financial Management Regulation," volume 1, May 1993, and DoD Directive 7220.9-M, "DoD Accounting Manual," chapter 94, October 1983. In addition, the report recommends that the DFAS train DAO/WHS employees to properly and accurately prepare general-purpose financial statements. The Deputy Director for Finance, DFAS, agreed with the recommendations for improving the financial statement preparation process, stating that all organizations to which DARPA provides funds will be required to submit their trial balances directly to the DFAS Indianapolis Center for consolidation. Also, the Directorate of Field Operations at the DFAS Denver Center will direct applicable personnel at DAO/WHS to attend the Department of the Treasury training course entitled "Understanding and Using the Standard General Ledger."

Inspector General, DoD, Report No. 96-003, "Defense Information Systems Agency FY 1994 General-Purpose Financial Statements," October 5, 1995, discusses whether the Defense Information Systems Agency used the DoD general ledger account structure to prepare FY 1994 financial statements and whether general ledger accounts in the structure were properly maintained. The report concludes that the Defense Information Systems Agency used budget execution reports instead of the DoD general ledger account structure to prepare FY 1994 financial statements. As a result, the statements omitted \$495 million in assets, \$12 million in liabilities, overstated operating expenses by about \$63 million, and misclassified liabilities of about \$199 million. Management concurred with all recommendations and agreed to make the recommended changes to correct the deficiencies.

Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995, discusses the adequacy of the DAO/WHS procedures for preventing duplicate and erroneous payments and for detecting and correcting such payments. The report concludes that the DAO/WHS procedures for preventing improper payments were inadequate. The DAO/WHS made either incorrect or improper payments, improperly certified vouchers, did not update the accounting system in a timely manner, and did not maintain proper supporting documents for obligations, accruals, and disbursements. In addition, the DAO/WHS did not use exception reports that identified accounting errors, did not consistently certify fund availability, and did not implement a management control program. The Deputy Director for Finance, DFAS, agreed to improve accounting procedures, recoup duplicate payments, and maintain proper supporting documentation for accounting transactions. The Deputy Director also agreed to implement a management control program and

Appendix B. Summary of Prior Audits and Other Reviews

to include an evaluation of the DAO/WHS operations in the FY 1995 Annual Statement of Assurance for the Defense Accounting Office, Air Force District of Washington.

Appendix C. Trial Balance Submission¹

<u>GLAC²</u>	<u>Account Title</u>	<u>Army</u>	<u>Navy³</u>	<u>Naval Air Warfare Center</u>	<u>WAAS</u>
101000	Fund Balance with Treasury				
101100	Funds Collected	\$ 2,614 D	\$ 79,233,304 D	\$786,962 C	\$ 10,200,377 D
101200	Funds Disbursed	156,794,961 C			918,019,069 C
101300	Funds With Treasury	612,944,604 D			3,373,556,562 D
101400	Undistributed Collections	2,614 C			
101500	Undistributed Disbursements	(103,397,476) D			
131100	Accounts Receivable- Government-Current				
131600	Refunds Receivable-Public				30,325,968 D
131900	Allowance for Loss on Accounts Receivable				516,164 D
141100	Travel Advances	(464) D			516,164 C
141200	Advances to Contractors and Suppliers	1,103,264 D			4,892 D
145200	Prepaid Expense-Military Personnel- Defense Business Operations Fund	(313,014) D			
176200	Military Equipment ⁴				1,713,414 D
183000	Automated Data Processing Software				192,695 D

D = Debit Balance C = Credit Balance

¹The Air Force submitted an adjusted trial balance to the DFAS Indianapolis Center that did not contain information on suballocations received from the DARPA. However, Army fiscal stations reported general ledger accounts, Funds Disbursed and Undistributed Disbursements, for the Air Force, the Defense Nuclear Agency (now the Defense Special Weapons Agency), and the NSA for FY 1995. The amounts reported by the Army represent cross-disbursements for travel pay for individuals and organizations supported by Army bases.

²General Ledger Account Code.

³The DFAS Cleveland Center submitted an adjusted trial balance for the Naval Air Systems Command, the Naval Sea Systems Command, and the Space and Naval Warfare Systems Command. However, the DFAS Cleveland Center submitted no information for the Office of Naval Research and other Navy organizations for FY 1995.

⁴This account should be listed as 175000, Equipment, which is used to represent tangible items of a durable nature except combat-type equipment which is listed as 176000, Military Equipment.

Appendix C. Trial Balance Submission

GLAC ²	Account Title	Army	Navy ³	Naval Air Warfare Center	WAAS
2110G	Accounts Payable-Government				
2110N	Accounts Payable-Public		284,551 C	2,782 C	
211100	Accounts Payable-Government-Current		2,536,322 C	398 C	
211300	Accounts Payable-Public-Current	5,157,532 C			11,092,117 C
221100	Accrued Payroll-Civilian	83,884,737 C			9,050,471 C
221300	Accrued Payroll-CESFR ⁵	226,490 C			437,500 C
222100	Accrued Annual Leave-Civilian (Unfunded)	35,611 C			69,438 C
310000	Appropriated Capital	(79,623) C			1,361,935 C
322000	Transfers in From Others Without Reimbursement	1,059,053,153 C	\$ 76,415,611 C		2,460,539,500 C
331800	Cumulative Results on Operations	138,817 C			
332800	Net Results on Operations	(306,883,750) C			
570000	Appropriated Capital Used	(167,288,122) C			
591000	Miscellaneous Reimbursements		113,174,008 C		912,954,942 C
6100G	Operating and Program Expense-Government				15,423,874 C
611100	Personnel Compensation-Civilian	2,626,423 D	113,174,008 D	\$790,142 D	16,186,785 D
611300	Personnel Benefits-Civilian	455,712 D			1,842,411 D
611600	Travel and Transportation of Persons	247,583 D			4,294,396 D
611700	Transportation of Things	12,617 D			(16,284) D
611800	Rent, Communications, and Utilities				8,008,790 D
611900	Printing and Reproduction	73 D			(218,303) D
612000	Other Services	316,950,275 D			868,032,888 D
612100	Supplies and Materials	270,695 D			796,411 D
612200	Equipment (Not Capitalized)	79,861 D			47,386 D
612300	Grants, Subsidies, and Contributions				13,980,462 D
613000	Annual Leave	59,194 D			
633000	Other Interest Expenses	118 D			
660000	Applied Overhead	(341) C			

D = Debit Balance C = Credit Balance

⁵Civilian Employer Share of Fringe Benefits.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Under Secretary of Defense (Comptroller), Washington, DC
Washington Headquarters Services, Arlington, VA

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller),
Washington, DC
Training Systems Division, Naval Air Warfare Center, Orlando, FL
Office of Naval Research, Arlington, VA

Department of the Air Force

Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Aeronautical Systems Center, Wright-Patterson Air Force Base, OH
Air Force Office of Scientific Research, Bolling Air Force Base, Washington, DC
Wright Laboratories, Wright-Patterson Air Force Base, OH

Defense Agencies

Defense Advanced Research Projects Agency, Arlington, VA
Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Cleveland Center, Cleveland, OH
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Accounting Office, Bolling Air Force Base, Washington, DC
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
Defense Accounting Office, Washington Headquarters Services, Arlington, VA
Defense Finance and Accounting Service, Tobyhanna, PA
Defense Special Weapons Agency, Alexandria, VA
National Security Agency, Fort Meade, MD

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)
Director for Budget and Finance, Washington Headquarters Services

Department of the Army

Auditor General, Department of the Army
Commander, U.S. Army Strategic Defense Command

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy
Chief of Naval Research
Chief, Training Systems Division, Naval Air Warfare Center

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Advanced Research Projects Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Cleveland Center
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Finance and Accounting Service Indianapolis Center
Defense Accounting Office, Washington Headquarters Services
Director, Defense Logistics Agency
Director, Defense Special Weapons Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Appendix E. Report Distribution

Non-Defense Federal Organizations and Individuals

Inspector General, Department of Education
Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional
committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Department of the Navy Comments



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20380-1000

23 JUL 1996

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

Subj: DRAFT AUDIT REPORT ON FINANCIAL MANAGEMENT AT THE DEFENSE
ADVANCED RESEARCH PROJECTS AGENCY (PROJECT NO. 6RF-2004)

Ref: (a) DODIG memo of 23 May 96

Encl: (1) Department of the Navy Response to DODIG Draft Report
of 23 May 96

The Department of the Navy (DON) has reviewed the subject draft audit report, forwarded by reference (a), and assessed the findings and recommendations contained therein. The DON response is forwarded in enclosure (1).

The DON concurs in part with the finding and concurs in principle with the recommendations concerning preparation of trial balance information for Defense Advanced Research Projects Agency (DARPA). Under Department of Defense (DOD) Finance and Accounting Responsibilities, Navy Finance and Accounting Matrices, which were in draft for several years prior to being finalized and approved by the Under Secretary of Defense (Comptroller) in December 1995, preparation of trial balances is the responsibility of the Defense Finance and Accounting Service (DFAS). DFAS Cleveland Center, who provides accounting services for the Office of Naval Research (ONR), has agreed to prepare the requested DARPA trial balance information beginning September 1996. DFAS Cleveland Center and ONR personnel are coordinating this effort.

Deborah R. Christie

DEBORAH R. CHRISTIE
Assistant Secretary of the Navy
(Financial Management and Comptroller)

Copy to:
(see next page)

Department of the Navy Response

to

DODIG Draft Report of 23 May 1996

on

Financial Management at the
Defense Advanced Research Projects Agency
(Project No. SRF-2004)

PART 1 - AUDIT RESULTS

Page 4, Finding A. FY 1995 DARPA Adjusted Trial Balance Submissions

"The Navy and the Air Force did not provide complete DARPA adjusted trial balances because Navy and Air Force accounting activities were not using general ledger reporting systems to record DARPA-related proprietary information."

DON Response: Concur in part. The DODIG identified only two Department of the Navy (DON) activities for which trial balance information was not provided, i.e., the Office of Naval Research (ONR) and Naval Systems Management Activity (NSMA). The Defense Finance and Accounting Service (DFAS) Cleveland Center is the accounting activity for ONR. In accordance with the Department of Defense Finance and Accounting Responsibilities, Navy Finance and Accounting Matrices, which were in draft for several years, prior to being finalized and approved by the Under Secretary of Defense (Comptroller) in December 1995, ONR was told verbally by DFAS Cleveland Center in November 1995 that they would prepare and forward the requested trial balance information for ONR. ONR does use the general ledger accounting system, Standard Accounting and Reporting System (STARS), used by all Navy activities. STARS is the official accounting system for DON, and ONR does input all DARPA suballotments, commitments and obligations. DFAS records all expenditures in STARS.

Page 7, Office of Naval Research Adjusted Trial Balance

"The Office of Naval Research did not prepare an adjusted trial balance because that office relies on the DFAS Cleveland Center for accounting support and for preparing the necessary financial reports for the DARPA funds. DFAS Cleveland Center personnel were unaware that the Office of Naval Research needed assistance to account for funds received from the DARPA....As a result of our audit, the Office of Naval Research prepared a memorandum, dated February 13, 1996, requesting that the DFAS Cleveland Center prepare and submit future annual adjusted trial

Department of the Navy Comments

balances for the Office of Naval Research portion of the DARPA appropriation as well as all future monthly adjusted trial balance reports requested by the DFAS Indianapolis Center.'

DON Response: Concur in part. It is correct that ONR did not prepare an adjusted trial balance. However, ONR was not included on the distribution of the 25 June 1995 DFAS Indianapolis Center memo instructing defense agencies and other submitters to prepare and submit monthly trial balances. DFAS Indianapolis Center did forward their memorandum to ONR via a Routing and Transmittal Slip dated 31 October 1995. Upon receipt of this memorandum the first week of November 1995, the ONR Comptroller Office contacted DFAS Cleveland Center to discuss the requested reports. DFAS Cleveland Center personnel assured the ONR Comptroller Office that since they were required to prepare the reports for the other Standard Accounting and Reporting System (STARS) users (i.e., Naval Air Systems Command, Naval Sea Systems Command, and Space and Naval Warfare Systems Command), they would prepare the report for ONR's portion of DARPA funds as well. At that time DFAS Indianapolis Center was informed by ONR that DFAS Cleveland Center was the office responsible for the preparation of the requested reports. ONR memorandum dated 13 February 1996 to DFAS Cleveland Center was a follow-up to ONR's verbal request. DFAS Cleveland Center forwarded ONR's request through their chain-of-command for approval to prepare and provide this data. DFAS Cleveland Center has now agreed to prepare the DARPA trial balance and general ledger account information, and provide this data to DFAS Indianapolis Center beginning September 1996.

Page 10. Recommendation A.1.

'We recommend that the Director, Defense Advanced Research Projects Agency, obtain assurances from fund recipient research activities that they will provide adjusted trial balance information for FY 1996 to the Defense Finance and Accounting Service Indianapolis for generating the Defense Advanced Research Projects Agency portion of the Department 97 financial statement.'

DON Response: Concur in principle. The accounting activities servicing the fund recipient research activities are responsible for preparing adjusted trial balance information, rather than fund recipient research activities. DFAS Cleveland Center is the accounting activity for ONR. We believe the recommendation should be revised to state: 'We recommend that the Director, Defense Advanced Research Projects Agency, obtain assurances from the accounting office which provides the support to fund recipient research activities that they will provide....'

Page 11. Recommendation A.2

'We recommend that the Commander, Office of Naval Research, and the Commander, Naval Systems Management Activity, prepare the

adjusted trial balance information, as requested by the Defense Finance and Accounting Service Indianapolis Center, that reflects the Defense Advanced Research Projects Agency suballotments received and expended for use in preparing the Department 97 financial statement."

DON Response: Concur in principle. We concur that adjusted trial balance information for DARPA suballotments received and expended must be provided. However, under the Department of Defense (DOD) Finance and Accounting Responsibilities, Navy Finance and Accounting Matrices, which were in draft for several years and were finalized and approved by the Under Secretary of Defense (Comptroller) in December 1995, preparing trial balances is the responsibility of DFAS. In November 1995 ONR requested DFAS Cleveland Center to prepare trial balance information for ONR that reflects DARPA suballotments received. This request was followed up in writing on 13 February 1996. DFAS Cleveland Center has agreed to prepare and provide this data to DFAS Indianapolis Center beginning September 1996, and a meeting is scheduled between DFAS Cleveland Center and ONR personnel to coordinate this effort. We believe the recommendation should be revised to read: "We recommend that the DFAS Cleveland Center prepare the adjusted trial balance information...."
(NOTE: The Chief of Naval Research is the commander of the Office of Naval Research.)

Defense Advanced Research Projects Agency Comments



ADVANCED RESEARCH PROJECTS AGENCY
3701 NORTH FAIRFAX DRIVE
ARLINGTON VA 22203-1714



JUL 30 1996

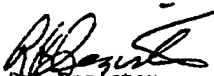
MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD IG

SUBJECT: Financial Management at the Defense Advanced Research
Projects Agency (Project No. 6RF-2006) dated May 23 1996

The Defense Advanced Research Projects Agency (DARPA) has reviewed the subject draft audit report and provides the following comments:

DARPA agrees with finding A.1. DARPA will formally notify allotment holders of financial statement reporting requirements NLT August 15 1996 and will include this topic in discussions at our annual conferences in an attempt to assure compliance. However, the absence of general ledger systems to capture and report proprietary information is a DoD-wide systemic problem that should be rectified by the Defense Finance and Accounting Service and not by requests from a Defense Agency to comply with DoD financial reporting requirements.

DARPA does not concur with IG finding E.1. to establish procedures for reporting the value of research equipment that meet capitalization criteria and purchased with RDT&E allotted funds. Although DARPA is assigned responsibility for the reliability of its financial statements, this Agency does not have the authority to direct the Military Departments to implement general ledger reporting systems to capture DARPA proprietary information. The fact that DARPA sends allotments to an installation has no impact on Military Department decisions to exclude DARPA allotments from standard reporting requirements. Accounting personnel are in place at the DFAS-Cleveland and DFAS-Denver centers and at each installation that have accounting and reporting responsibility for DARPA allotments.


Ron Register
Deputy Director, Management

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-8291

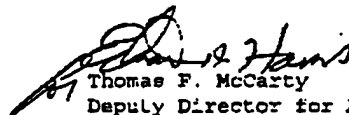
JUL 29 1996

DFAS-HQ/AFR

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT
DIRECTORATE, OFFICE OF THE INSPECTOR
GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Management Comments on the Audit Report of
Financial Management at the Defense Advanced
Research Projects Agency (Project Number 6RF-2004)

The subject report has been reviewed and our management
comments are attached. Please direct any questions
concerning this matter to Ms. Martha Cooper at (703)607-5102
or DSN 327-5102.


Thomas F. McCarty
Deputy Director for Accounting

Attachment

Defense Finance and Accounting Service Comments

Subject: Audit Report of Financial Management at the
Defense Advanced Research Projects Agency
(Project No. 6RF-2004)

Recommendation B.2. The Defense Finance and Accounting (DFAS) tasked the (Defense Finance and Accounting Service), Indianapolis Center, to:

(a) Review the Defense Advanced Research Agency Military Equipment account, and make adjusting entries to eliminate any part of the account balance that does not meet the unit capitalization threshold criteria.

(b) Record only the expenses that are incurred during the current fiscal year for all general ledger expense accounts.

Management Comments to (a): Partially concur. The DFAS agrees that an adjustment is required to the general ledgers. However, the adjustment will be made based on input from the property book officers. The adjustment will be made by the property book officers as they apply the capitalization threshold to the property balances prior to reporting to the DFAS for input to the general ledger.

The draft report recognizes in finding B that the DFAS is not currently receiving personal property reports from property book officers responsible for reporting DARPA's balances. Even after DARPA implements recommendation B.1., the DFAS still will not be in a position to determine whether the capitalization threshold was properly applied since the DFAS does not have access to the subsidiary records of the property book officers. However, once DFAS acquires a baseline of reported values for use in comparison against the reported values in the future, a variance analysis can be conducted to determine if potential over/under reporting is occurring based on historical trends.

Management comments to (b): Concur. We agree that prerecording expenses constitute improper use of the expense account. Therefore, the DFAS-IN will no longer record the accrual of transportation and printing expenses while simultaneously recording the obligations.

Additional management comments: We nonconcur with the comments on pages 6 and 7, last and first paragraphs, respectively. The DARPA funds are accounted for in the Standard Accounting and Reporting System Headquarters Module (STARS-HCM). The STARS-HCM is a general ledger based system utilizing the Uniform General Ledger Accounts chart of accounts. Therefore, the statements that the DFAS-CL and the Office of Naval Research (ONR) are not using a general ledger system, are incorrect.

We also nonconcur with the fourth paragraph on page 7. The ONR and the Naval System Management Activity (NSMA) have accounted for their DARPA funds for years. The ONR asked DFAS-CL about performing the reporting function and DFAS-CL formally accepted (July 1996). Consolidating the DARPA reporting in DFAS-CL would be a logical step in the reporting process. In conclusion, the DFAS-CL was not requested to report ONR's or NSMA's DARPA funds until July 1996. The DFAS-CL will begin reporting for ONR and NSMA in August 1996 for the July 1996 accounting month.

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